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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 000173

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TAGS: ENRG AJ TU GA PREL PGOV

SUBJECT: AZERBAIJAN: SOCAR SAYS USG MUST HELP WITH  
KAZAKHSTAN, TURKMENISTAN ENERGY

REF: BAKU 132

Classified By: DCM Jason P. Hyland, Reasons 1.4 (b,d)

¶1. (C) SUMMARY: In a January 25 meeting with the Ambassador, SOCAR President Rovnaq Abdullayev defended the recent rise in energy prices, saying that energy could not be sold below cost and that prices had to be normalized. The GOAJ was keeping the public in the dark about the "huge expense" of converting oil to heavy fuel for use in power plants, as a result of avoiding buying gas from Gazprom. In addition to its own gas reserves, the GOAJ was looking to Turkmen and/or Kazakh gas to meet the European demand for Caspian gas. For Caspian gas to move to Europe a transit regime agreement with Turkey was essential, and Abdullayev asked for USG help in this regard. The GOAJ and related companies were ready to move on an Intergovernmental Agreement, but lack of progress was due primarily to Kazakh political considerations and differences between the government and the companies involved. Abdullayev welcomed news of the February 7 US-Azerbaijan "Energy Diplomacy Dialogue" as a way to "push things forward." He said that Azerbaijan would have the ten billion cubic meters of gas ready to provide to the Nabucco project o/a 2012, and said that SOCAR was considering becoming the sixth Nabucco partner. END SUMMARY.

¶2. (C) On January 25 the Ambassador met with SOCAR President Rovnaq Abdullayev. Also present were SOCAR Foreign Investments Division General Manager Vagif Aliyev and EnergyOff (as notetaker).

ENERGY PRICE RISES ARE GOOD

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¶3. (C) Concerning the January increase in energy prices as dictated by the Tariff Council (ref a), Abdullayev said that the government had been selling energy below cost and needed to 'normalize' these prices - "for over ten years no one wanted to do these changes - reforms are always difficult." But the energy sector needed extensive reforms, to include registration and fee collection. He said that "the people understand" that the price increases will help Azerbaijan's development, "will make the energy sector more efficient and help attract more foreign investment." Non-targeted subsidies are bad, and stop development. Part of the GOAJ's efforts would be to teach Azerbaijanis to economize in their domestic energy use. The GOAJ used 600 to 700 million manats to eliminate these energy subsidies, and President Aliyev's economic decrees to increase salaries will cost the state budget over one billion manats, whereas increasing the gas prices will result in only 200 million manat additional government revenue. If AzerEnergy has one hundred percent collection rates, the increased electricity prices will

result in additional 150 to 200 million manat government revenue.

#### ENERGY CORRIDOR

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¶ 14. (C) Were it not for the production problems with Shah Deniz, Abdullayev said that Azerbaijan and Georgia would be experiencing energy security, no longer dependent on Russia. Despite these Shah Deniz problems, the GOAJ has chosen to refuse the Russian gas being offered at USD 235 per thousand cubic meters, instead refining its own oil, originally intended for export, for use as mazout in domestic power plants in place of gas. Abdullayev said that this strategy is resulting in a "huge economic loss" for the government, about which the public is being kept in the dark. In the longer term, Abdullayev was confident that the gas situation will be normalized, with the goal being the GOAJ covering its own gas energy needs by the end of 2008. In this regard, SOCAR would pursue an ambitious program to expand its own domestic gas production. He said that the GOAJ's first priority was the domestic market, with any surplus gas to be exported to Europe. As for Georgia, he said that the government wants to help, but is also aware of the criticism that the government sells gas cheaply to Georgia while charging its own people more. Meanwhile, Abdullayev said that Russia was "not sleeping," and had its own plans to counter Caspian gas from reaching Europe.

#### TURKMENISTAN/KAZAKHSTAN

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¶ 15. (C) Abdullayev said that he sensed 'new opportunities'

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for the Southern Energy Corridor. Abdullayev said that the SCP gas pipeline was ready and that the "Southern Corridor was working." As for marketing Shah Deniz gas, SOCAR was in ongoing negotiations with DEPA and Edison re the TGI pipeline. He had also had "good discussions" with the visiting OMV CEO Ruttenstorfer the previous day (ref b), whom he told that starting in 2012 approximately 10 bcm of Shah Deniz gas would be available for export to Europe (2 bcm/a to Greece and 8 bcm/a to Italy). However, Shah Deniz would not be sufficient for both TGI and Nabucco, and as such Azerbaijan was seeking to develop other domestic fields.

¶ 16. (C) Even with increased domestic gas production, Abdullayev said that it would be important for the GOAJ to talk with Kazakhstan and Turkmenistan about getting their gas transiting westward. Although "Russia and Iran wouldn't like it," Abdullayev stressed that the best route for Turkmen gas was through Azerbaijan, and he asked for USG help in convincing Turkmenistan to look westwards for its gas sales. Abdullayev and the Ambassador agreed that construction of an approximately 80 kilometer pipeline to connect offshore Turkmen fields to the Azerbaijani gas pipelines would be a relatively easy and inexpensive first step. Concomitantly, Abdullayev added that Turkey had to be ready, both technically and in terms of an equitable transit regime, to transit any gas coming from across the Caspian. Giving Abdullayev the latest official statements by State Department spokesman Boucher on Turkmenistan, the Ambassador said that the USG was "very interested" in a new relationship with Turkmenistan, that it supported multiple gas export pipelines for Turkmenistan, and that it was looking forward to working with Azerbaijan in this regard. She added that the USG was particularly interested in the offshore 'Block Number One' field, where Petronas is the operator.

#### ENERGY BILAT

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¶ 17. (C) The Ambassador said that a high-level delegation was coming to Azerbaijan February 5-7, both to launch a bilateral Economic Partnership Commission and also to initiate a new

dialogue on energy. The USG proposed a meeting on February 7 to discuss bilateral energy issues, with the USG participants representing "all parts of the puzzle:" EB A/S Sullivan, SCA PDAS Steve Mann (responsible for Kazakhstan and Turkmenistan), and EUR DAS Bryza, and these interlocutors would be quite interested in hearing his opinions.

¶ 18. (C) Abdullayev said that such a high-level visit would help "push things forward." He didn't have much insight into Turkmenistan, although he added that during Soviet times Turkmen energy production was administratively under Azerbaijani supervision. At one point after independence Petronas had proposed to President Niyazov a joint project with SOCAR, but Niyazov turned down the project due to SOCAR involvement, even though the resulting project without GOAJ participation was far more expensive than it would have been otherwise. Abdullayev said there were other occasions where Turkmenistan incurred vastly increased expenses rather than allow Azerbaijani participation in the Turkmen energy sector.

¶ 19. (C) With Niyazov's passing, SOCAR was still keenly interested in helping Turkmenistan with developing its energy infrastructure. Abdullayev said that SOCAR was ready from a technical viewpoint; what he was waiting for was a political agreement that would allow him to go forward. Most of Azerbaijan's large energy-related construction projects were drawing to a close, and Abdullayev said he did not want to lose the trained workforce - "if we stop for one or two years, they will go." The Ambassador repeated that there would be a strong new effort at energy diplomacy from the USG, that the upcoming February 7 meeting would be very important in this regard, and she asked Abdullayev to think over what issues the GOAJ should address in such a meeting.

HGA

¶ 10. (C) Abdullayev said that no concrete decisions had been made concerning an HGA, and that Kazakhstan seemed "unready" to proceed. The problem seemed to be between the Kazakh government and the various partners, which has resulted in a delay in the start of Kashagan until 2011-2012. The Kazakh government wants to build the related infrastructure in Kazakhstan, vice allowing some of the infrastructure to be

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built in Azerbaijan, which was slowing down the process and increasing expenses. The Ambassador asked what the USG could do to move the process forward, to which Abdullayev replied that he could not tell Kazakhstan how to best act in its own interest, adding that Azerbaijan was ready to ship Kazakh oil whenever Kazakhstan was.

TURKISH TRANSIT

¶ 11. (C) Abdullayev said the next scheduled discussions with Turkey are to be o/a February 6, at which time redistribution of Shah Deniz gas will be discussed. He envisioned that by summer Shah Deniz gas would be going to Turkey, and some gas through Turkey to Europe. At this point the GOAJ was not discussing transit issues with the GOT. The GOT thinks that if a transit arrangement is worked out with GOAJ, then Iran also will seek one with Turkey. When the Ambassador asked how the USG could help facilitate GOAJ-GOT dialogue on a transit regime, Abdullayev said that the USG should 'send a message' to Turkey to encourage its willingness to engage on this issue, which was the key to the whole "Southern Corridor" project. There also has to be a new agreement among Botas and the Azerbaijan Gas Supply Company (AGSC - the marketing entity for Shah Deniz gas) for transit of additional (i.e. Phase Two) Shah Deniz gas. There also needs to be an additional agreement for the 300 mcm of GOAJ gas earmarked for Greece, which could be either Shah Deniz gas or other SOCAR gas.

NABUCCO

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¶12. (C) In response to the Ambassador's question, Abdullayev said that there would be 10 bcm of export gas available for the Nabucco pipeline in 2012. He said that he had had a very positive meeting with the head of OMV, who had paid his first visit to Azerbaijan (ref b). Pointing out that the Nabucco Project has five partners each with a twenty percent share, Abdullayev said that SOCAR might well seek to become the sixth Nabucco partner.

HOW MUCH GAS?

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¶13. (C) In response to the Ambassador's question about gas reserve estimates, Abdullayev said that Shah Deniz has over one trillion cubic meters of proven reserves, and that GOAJ as a whole has 2 trillion cubic meters of proven reserves and 4-5 trillion cubic meters of estimated but not proven reserves. He said estimates of ACG deep gas were above 500 thousand billion cubic meters.

¶14. (C) COMMENT: The visit of OMV CEO Ruttenstorfer to Baku (ref b) and his meeting with Abdullayev were useful in focusing SOCAR attention on gas quantities that need to be available starting o/a 2012. Abdullayev's comments about the need to draw in Kazakhstan and/or Turkmenistan gas also indicate his awareness that for significant gas to be available for export west in the short- to mid-term, in addition to developing Shah Deniz Phase Two, ACG Deep gas and other domestic reserves, Azerbaijan needs to look east across the Caspian. END COMMENT.

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